

FINANCIAL ACCOUNTING EXAM 1.3

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- The exam packet is comprised of :
 1. This 19-page document, which contains the questions you are to answer. Write all of your answers in this document, put your name on each page, and submit the document for grading.
 2. The Exam Supplement, which contains a chart of accounts for **all** exam entries, BSE matrix for a fictitious company, the essay background text and tabular data, and financial statements for the following real companies:
 - Southwest Airlines Co. operates Southwest Airlines (“Southwest”) and AirTran Airways (“AirTran”), major passenger airlines that provide scheduled air transportation in the United States and near-international markets. (2013 annual report)
 - AT&T is a leading provider of telecommunications services in the United States and the world. (2013 annual report)
 3. Scrap paper. Additional scrap paper is available at the front of the room.
- There are 20 possible points on the exam that can be applied to your course grade. Except for the essay portion of the exam, partial credit will not be awarded, so check your answers carefully.
- If, in our sole judgment, we cannot read your essay responses to question 5, you will not receive full credit. If it’s determined we cannot read your responses, you will be contacted and given an opportunity to type up your responses EXACTLY as written in your exam by a given time. No content changes are allowed. In this case, you will be penalized 1 point for not writing clearly.
- The exam is closed book and closed notes.
- You cannot use a laptop, tablet, cell phone, or other communication or mobile device.
- You may use a basic calculator (not to be shared with others). However, your calculator must not contain course related information. Additionally, your calculator must not be capable of storing “text” or communicating with others (no cell phones or other text messaging devices are permitted). We reserve the right to inspect your calculator and, in our sole judgment, deem it inappropriate for use during the exam. We will have basic calculators available for you to borrow.
- Once the exam starts, you may not take any materials from the room, including the exam document, the exam supplement, or any scrap paper (provided) until you have completed the exam and submitted your exam document to the Professor or Exam proctor.
- To protect the vast majority of students who will not cheat on the exam, there may be alternative versions of the exam that are the same in all respects except the questions contain some numbers that differ or are arranged differently.
- Regardless of one’s intent, staring at classmates’ exams is inappropriate. If you wish to take a break from staring at your exam, stare directly ahead or to either side without looking down.
- More generally, you are to honor the school’s core values in all respects.

Question 1

For parts (a) - (d) you are to record journal entries for Pop’s Bakery in the spaces provided **using accounts from the chart of accounts in the supplement**. *Check your work carefully, no partial credit.*

(1/2 point each, for a total of 2 points)

Part 1(a)

Record a journal entry for the following payment:

On January 1, 2014, Pop’s Bakery paid employees \$30 thousand for services rendered during December 2013. Pop’s had recognized the related compensation expense in an earlier adjusting entry on December 31, 2013. Record the January 1, 2014 compensation payment.

Note: Four rows have been provided, but you may not need them all.

	<u>Debit</u>	<u>Credit</u>
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

Part 1(b)

Record a journal entry for the following usage of rental property:

On December 31, 2013, Pop’s Bakery paid \$24 thousand rent for the right to use a store during 2014. Record the January 31, 2014 adjusting entry that recognizes the store’s usage during January, 2014.

Note: Four rows have been provided, but you may not need them all.

	<u>Debit</u>	<u>Credit</u>
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

Part 1(c)

Record a journal entry for the following truck usage:

On January 1, 2014, Pop’s Bakery purchased a delivery truck for \$45 thousand. On December 31, 2014, Pop’s concluded that \$9 thousand of the \$45 thousand cost of the truck should be assigned to usage during 2014. None of this usage had been recorded prior to December 31, 2014. Record the December 31, 2014 adjusting entry to recognize this usage.

Note: Four rows have been provided, but you may not need them all.

	<u>Debit</u>	<u>Credit</u>
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

Part 1(d)

Record a journal entry for the following:

On December 15, 2014 Pop’s Bakery received \$20 thousand cash when it sold another truck with \$40 thousand of historical cost and \$25 thousand of accumulated depreciation. Record the truck sale. Consistent with US GAAP, Pop’s Bakery had not previously recognized any unrealized gains associated with the truck.

Note: Four rows have been provided, but you may not need them all.

	<u>Debit</u>	<u>Credit</u>
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

Question 2

For parts (a) - (c) you are to create a balance sheet, income statement and statement of changes in owners' equity for Cece's Golf Apparel Company after you complete the closing entries in the **BSE matrix in the separate exam supplement**. You will not receive credit for completing the BSE matrix.

(1/2 point for each statement, for a total of 1.5 points)

Part 2(a)

Complete the following balance sheet for Cece's Golf Apparel:

Cece's Golf Apparel Company Balance Sheet		
First year of operations		
Assets	End Bal	Beg Bal
Current		
Cash	_____	\$0
Accounts receivable	_____	0
Inventories	_____	0
Total current assets	_____	0
Non-current assets		
Property, plant, and equipment, net		
Historical cost of PP&E	_____	0
Less accumulated depreciation	_____	0
Property, plant and equipment, net	_____	0
Total non-current assets	_____	0
Total assets	=====	\$0
Liabilities and Stockholders' Equity		
Liabilities		
Current		
Accounts payable	_____	0
Total current liabilities	_____	0
Non-current	_____	0
Total liabilities	_____	0
Stockholders' equity		
Common stock	_____	0
Retained earnings	_____	0
Total stockholders' equity	_____	0
Total liabilities and stockholders' equity	=====	\$0

Part 2(b)

Complete the following income statement for Cece's Golf Apparel:

Cece's Golf Apparel Company	
Statement of Comprehensive Income	
First year of operations	
Operating profit	
Revenues	_____
Cost of sales	_____
Depreciation	_____
Operating profit	_____
Non-operating profit	
Interest income	_____
Net profit	_____
Other comprehensive income	_____ 0
Comprehensive income	=====

Part 2(c)

Complete the following statement of changes in owners' equity for Cece's Golf Apparel:

Cece's Golf Apparel Company				
Statement of Changes in Equity				
First year of operations				
	<u>Common Stock</u>	<u>Retained Earnings</u>	<u>Reserves</u>	<u>Total</u>
Beginning balances	\$0	\$0	\$0	\$0
Comprehensive income				
Net profit	_____	_____	_____	_____
Other comprehensive income	_____	_____	_____	_____
Total	_____	_____	_____	_____
Common stock issued	_____	_____	_____	_____
Dividend declared	_____	_____	_____	_____
Ending balances	=====	=====	=====	=====

Note: Many of the above blanks may be zero or left blank.

Question 3

RELEVANT INFORMATION for QUESTION 3

Base your responses on: (i) Southwest Airlines's financial statements in the supplement; (ii) the Revenue Recognition section of Southwestern Airline's Summary of Significant Accounting Policies footnote; (iii) the customer-related events described below.

Revenue Recognition

Tickets sold are initially deferred as Air traffic liability. Passenger revenue is recognized when transportation is provided. Air traffic liability primarily represents tickets sold for future travel dates and estimated refunds and exchanges of tickets sold for past travel dates. The majority of the Company's tickets sold are nonrefundable. Refundable tickets that are sold but not flown on the travel date can be reused for another flight, up to a year from the date of sale, or refunded. A small percentage of tickets (or partial tickets) expire unused. The Company estimates the amount of tickets that expire unused and recognizes such amounts in Passenger revenue once the scheduled flight date has passed. Prior to September 13, 2013, funds associated with tickets in which a passenger did not show up for a flight without canceling were able to be reused on another flight for up to twelve months. On September 13, 2013, Southwest implemented a No Show policy that applies to nonrefundable fares that are not canceled or changed by a Customer at least ten minutes prior to a flight's scheduled departure. Based on the Company's revenue recognition policy, revenue is now recorded at the flight date for a Customer who does not change his/her itinerary and loses his/her funds. This change in Company policy did not have a significant impact on the amount of spoilage revenue recorded during 2013 or the Company's estimate of the amount of spoilage it expects to record in future periods. Amounts collected from passengers for ancillary services such as baggage and other fees are generally recognized as Other revenue when the service is provided, which is typically the flight date.

Southwest Airline's 2013 10K, Page 83

Assumed Customer-Related Events

- **May 11, 2014:** Southwest Airlines sold two tickets to a customer for a total of \$397: (1) \$156 for a ticket to fly from Manchester, New Hampshire, to Atlanta, Georgia, on July 30, 2014; and (2) \$241 for a ticket to fly from Atlanta, Georgia, to Manchester, New Hampshire, on August 7, 2014. The customer used a Visa card to purchase the ticket, which you can treat as cash (because Southwest can quickly convert it to cash).
- **July 30, 2014:** The customer uses the ticket purchased on May 11, 2014 for \$156 to fly from Manchester, New Hampshire, to Atlanta, Georgia.
- **August 7, 2014:** The customer who purchased a ticket for \$241 on May 11, 2014 to fly from Atlanta, Georgia, to Manchester, New Hampshire fails to show up for the flight. The customer did not change her itinerary or otherwise notify Southwest Airlines prior to missing this flight.

Continued on next page.

Directions for 3(a)-(b): (i) Write your journal entry in the space provided below. (ii) Use the *most* appropriate accounts from the chart of accounts in the supplement (it contains some accounts that are not appropriate). (iii) *Check your work carefully, no partial credit.*

Part 3(a)

Record Southwest Airline’s journal entry to recognize the ticket sales on May 11, 2014. (1 point)

Recognize selling tickets for \$397 on May 11, 2014.		
	<u>Debit</u>	<u>Credit</u>

Part 3(b)

Record Southwest Airline’s journal entry (if any) when the customer misses a flight on August 7, 2014. (1 point)

Note: If no entry is needed, write “NONE” in the space below. No credit if the space is left blank.

Recognize customer failing to use a \$241 ticket on August 7, 2014.		
	<u>Debit</u>	<u>Credit</u>

Question 4

Part 4(a)

RELEVANT INFORMATION for QUESTION 4(a)

Base your response to 4(a) on AT&T’s financial statements in the supplement and the following information:

Distributions to non-controlling interests

For the purpose of this exam, *treat distributions to non-controlling interests as if they are dividends.*

If you’re curious: Some of the entities for which there are non-controlling interests are likely partnerships rather than corporations. Dividends are distributions to corporate shareholders, whose ownership interests are shares. They don’t include distributions to the owners of partnerships, which are economically similar before considering taxes.

Record a journal entry that summarizes the entries entities controlled by AT&T (including the parent company) recorded during the year ended December 31, 2013 to declare dividends to parties with claims on AT&T’s consolidated net assets. (1 point)

Recognize dividends declared to all parties who have claims on net assets controlled by AT&T for the year ended December 31, 2013		
	Debit	Credit

Part 4(b)

RELEVANT INFORMATION for QUESTIONS 4(b) and 4(c)

Base your responses to 4(b) and 4(c) on AT&T’s financial statements in the supplement and the following information:

Impairment of intangible assets (Page 3 of Management Discussion and Analysis section of AT&T’s 2013 10K)

“In 2011, we recorded noncash charges for impairments in our Advertising Solutions segment, which consisted of a \$2,745 goodwill impairment and a \$165 impairment of a trade name.”

Trade name (Wikipedia)

“A trade name, trading name, or business name, is a name that a business uses for trading commercial products or services. A business may also use its registered, legal name for contracts and other formal purposes.”

Record a journal entry that summarizes the entries AT&T recorded during the year ended December 31, 2011 to impair intangible assets. Note the year is 2011, not 2013. (1 point)

Recognize AT&T's intangible impairments for the year ended December 31, 2011		
	Debit	Credit

Part 4(c)

Identify the AT&T financial-statement line items that were affected by the 2011 intangibles impairments entry in Part 4(b) and the direction of these effects (as indicated below).

NOTE: The balance sheets in the supplement are for December 31, 2012 and 2013. For the purpose of this exam, you can assume the balance sheet for December 31, 2011 (not included in the supplement) had the same captions as in the supplement and the reported amounts had the same signs.

(1/2 point per statement, for a total of 1 1/2 points.)

If an incorrect entry in part 4(b) leads to errors here, you won't receive credit here. Thus, check your response to part 4(b) entry carefully.

Guidance:

- (1) Determine the appropriate line item(s) affected using AT&T's statements. For example, write "cash and cash equivalents" rather than "cash" because this is on AT&T's balance sheet. Thus, **write the line-item caption reported on the financial statement (verbatim) rather than the account name.**
- (2) Include line item(s) directly affected, including the effect(s) of closing entries for events affecting income. Ignore taxes.
- (3) Don't include totals or sub-totals indirectly affected by the entry. For example, don't report "net income" on the income statement. However, net income is NOT a total on the statement of changes in shareholders' equity.
- (4) Three lines were included below for each statement, but you may need none or more than one line. **Write "NONE" if no line item is effected on the statement.**
- (5) Indicate if the effect(s) of the entries associated with the above event increased or decreased the line item. Put an X in the appropriate column if the above event increases or decreases that line item. For full credit, be sure to mark only one box in each statement's row. **NOTE: If a reported negative number changes from -2 to -3, it decreases; if it changes from -2 to -1, it increases.**
- (6) You won't receive credit for a statement if you list line items not affected by the entry: don't guess!

Financial-statement effects of 2011 intangibles impairments.					
Consolidated Balance Sheets			Consolidated Statements of Income		
Line Items	Increases	Decreases	Line Items	Increases	Decreases
	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Consolidated Statements of Changes in Stockholders' Equity					
Line Items	Increases	Decreases			
	<input type="checkbox"/>	<input type="checkbox"/>			
	<input type="checkbox"/>	<input type="checkbox"/>			
	<input type="checkbox"/>	<input type="checkbox"/>			

Part 4(d)

RELEVANT INFORMATION for QUESTION 4(d)

Base your response to 4(d) on AT&T’s financial statements in the supplement and the following information:

Depreciation and amortization

For the purpose of this exam, assume: (i) AT&T’s depreciation and amortization totalled \$18,395 for the year ended December 31, 2013 and (ii) it was all associated with property, plant and equipment, customer lists and relationships, or other non-current intangible assets.

Determine the direct effect(s) on the following AT&T metrics, everything else equal (ignore taxes) from recognizing depreciation and amortization during fiscal 2013.

(1/4 point per ratio, for a total of 1 point.)

Guidance:

Include the direct affects, including the effect(s) of closing entries for events affecting income.

You must put an “X” in the appropriate box to receive credit. You will not receive credit if you put an X in more than one box per metric.

	Increases	Decreases	No Effect
Current ratio (current assets / current liabilities) _____	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Financial leverage (liabilities / assets) _____	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Gross margin percentage ((revenues - cost of sales) / revenues) _____	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Return on equity (ROE) (net profit / average owners' equity) _____	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Question 5

RELEVANT INFORMATION for QUESTION 5

The format for question 5 requiring analyses is similar to the group assignments.

While there aren't correct responses to the question, some are definitely better than others. Generally, responses are better to the extent they are well organized, concise, use proper grammar, identify the most important arguments, counterarguments, and rebuttals, include appropriate qualifiers, and provide insights regarding the way you assessed the relative merits of the arguments, counterarguments and rebuttals.

Additionally, responses must cite sources and use quotation marks when copying word for word.

YOU MUST WRITE CLEARLY WITHIN THE GIVEN LINES TO RECEIVE CREDIT. YOU DO NOT NEED TO USE ALL THE SPACE TO RECEIVE FULL CREDIT. THE MARGINS ARE RESERVED FOR GRADING COMMENTS.

If, in our sole judgment, we can not read your response you will not receive full credit.

(total of 10 points)

Required

In this question, you will explore **Adidas Group's** and **Nike Inc.'s** future return-on-equity (ROE), growth rates, and risks.

Based solely on concepts covered thus far in the course and the provided background text information and tabular data IN THE EXAM SUPPLEMENT, **which company, Adidas or Nike, appears to have the better future prospects at the most recent balance sheet dates, taking into consideration expected future ROEs, growth rates, and risks?**

- Note: If you conclude one company doesn't dominate the other on all three factors (ROEs, growth rates and risk): (1) In your opening remarks, identify the company that has the best prospects for each of the factors; and (2) incorporate the companies' relative strengths into your arguments, counterarguments, and the confidence you attribute to your claim
- Use the Analysis Consideration Map - Phase 2 in the Exam Supplement to help you develop a response that integrates the qualitative and quantitative background information.
- Respond to this question by completing the templates in Parts I-III.

Background Information

The provided background text information and tabular data are IN THE EXAM SUPPLEMENT.

Part I: Your qualified claim and opening remarks

Claim:

Fill in the blank with either **Adidas** or **Nike**:

_____ appears to have the better future prospects at the most recent balance sheet dates, taking into consideration expected future ROEs, growth rates, and risks.

Qualifiers:

Put an X at the spot on the scale below that indicates the likelihood your claim is correct, given the available information and concepts covered thus far.

After completing Parts II and III, put an X at the spot on the scale below that indicates the likelihood your claim is correct, given the available information and concepts covered thus far. Your response should depend on the strength of your arguments, counterarguments, and rebuttals to counterarguments. For example, when you conclude your arguments and counterarguments are equally strong, your X will be near the middle of the scale. By contrast, when you conclude your arguments are very strong and there are no viable counterarguments, your X will be near the right end of the scale.

Given these directions, your response should ignore the possibility that other relevant information exists that could change your arguments, counterarguments, or rebuttals, and thus the confidence you have in your claim.



The Toulmin Method of Argumentation: The Second Triad, Keith Green
http://www.youtube.com/watch?v=-gRaC_vZiD8

